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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY, AND FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS EASTERN GROUP AND FOR CERTAIN RELATED APPROVALS.	DOCKET NO. W-01445A-11-0310 **ARIZONA WATER COMPANY'S** **REPLY BRIEF**

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I. INTRODUCTION

Arizona Corporation Commission Staff ("Staff") and the Residential Utility Consumer Office ("RUCO") docketed their Briefs in this matter on June 26, 2012. Those briefs reveal a handful of disputed issues remaining in this case, including implementing a Distribution System Improvement Charge ("DSIC"), the appropriate return on equity (and associated overall rate of return on rate base), as well as several revenue and expense adjustments proposed by the parties. As pointed out in Arizona Water Company's ("Arizona Water Company" or the "Company") Brief, also dated June 26, 2012 ("Company's Brief"), the RUCO and Staff positions on these contested issues often lack sufficient evidentiary or legal support, or otherwise conflict or are inconsistent with case law and well established best practices for setting appropriate rates. As a result, Arizona Water Company submits that the Commission should adopt a DSIC mechanism for the Company's Superstition, Cochise and Falcon Valley systems, and that the Commission should determine that the fair value of the Company's utility plant and property is $63,560,931 and authorize a rate of return on fair value rate base of 9.72 percent.

The majority of the arguments and positions taken by RUCO and Staff in their Opening Briefs were addressed and rebutted in the Company's Brief. This Reply Brief will focus on the issues raised in those parties' Briefs that were not already fully addressed, and will reference and incorporate the Company's Brief as appropriate as to arguments already made.[1]

II. DISTRIBUTION SYSTEM IMPROVEMENT CHARGE

The main source of disagreement remaining between the parties is with respect to the implementation of a DSIC in the Company's Eastern Group. Over half of the RUCO Brief argues against the need for and basis of a DSIC, while the Staff devotes a significant portion

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[1] For purposes of this Reply Brief, the Company will utilize the same naming and citation conventions used in Company's Brief. RUCO's Brief dated June 26, 2012 will be cited as "RUCO Brief," while Staff's Brief dated June 26, 2012 will be cited as "Staff Brief."

of its Brief to essentially the same topics. Staff's and RUCO's opposition and arguments are largely unsupported by the evidence in the record and should be rejected.

A. Issues Raised By Both RUCO and Staff.

1. Arizona Water Company Conclusively Demonstrated That it is Facing an Unprecedented and Extraordinary Infrastructure Replacement Crisis Justifying a DSIC in its Eastern Group Systems.

As discussed in detail in the Company's Brief, there is no meaningful dispute about the nature and extent of the infrastructure replacement needs facing the Company. [Company's Brief at p. 5, l. 24 – p. 14, l. 23; *see also* RUCO Brief at 15, ll. 7-8 ("There is no dispute that there is antiquated infrastructure in the systems in question")]. Nor, as detailed below and in the Company's Brief, is there any real dispute that current ratemaking practices are insufficient to deal with this crisis. [*See* Company's Brief at p. 15, l. 11 – p. 16, l. 21]. Despite these undisputed facts, both Staff and RUCO argue that the Commission should decline to adopt a DSIC for the Company's Eastern Group systems on the grounds that the infrastructure replacement requirements facing the Company are not extraordinary and are the Company's responsibility because the Company did not replace failing infrastructure over the years. [Staff Brief at p. 27, l. 18 – p. 28, l. 5; RUCO Brief at p. 15, ll. 7-16].

The overwhelming weight of the evidence in the record demonstrates that RUCO and Staff are incorrect. As the Company's pre-filed and live hearing testimony and evidence clearly show, the Company regularly replaces failing infrastructure. [Exs. A-9, Harris Direct at p. 14, ll. 13-20; A-28, Schneider Direct at p. 43, l. 18 – p. 49, l. 23; *see also* Tr. at p. 533, ll. 18-24; p. 614, ll. 9-25]. The Company's ongoing replacement efforts are limited, however, by the resources available to the Company and the magnitude of the replacement needs facing the Company. [Company's Brief at p. 14, l. 26 – p. 17, l. 11; Tr. at p. 82, ll. 3-13.] Water rates over the past 15 years have not produced enough revenues for the Company to recover all of its cost of providing water service (a fact not addressed by either Staff or RUCO in their briefs). [Ex. A-10, Harris Rebuttal at p. 5, l. 18 - 6, l. 22; Tr. at p.

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332, ll. 7-18]. As a result, the Company has only been able to replace, on average, approximately 7,400 lineal feet of mains per year in its Superstition, Cochise and Falcon Valley systems. [Ex. A-9 at p. 14, ll. 11-15]. Neither Staff nor RUCO supported adopting the Company's requested rate of return in order to allow it to fund additional needed utility plant replacements. Indeed, both seek to depress the Company's authorized rate of return to a level that will prevent the Company (despite cost-cutting over the last several years) from obtaining sufficient investment capital needed to replace failing infrastructure. [Company's Brief at p. 28, l. 20 – p. 29, l. 3].

Even with the Company's ongoing replacement program, it identified—without contradiction—approximately 371,000 feet of water mains in its Eastern Group that need replacing in the next three to ten years, in addition to thousands of service lines that require immediate replacement. [Ex. A-28, FKS-13; Company's Brief at p. 7, l. 21 - p. 8, l. 11]. As noted during the hearing, much of the infrastructure that now needs replacing was installed over relatively short periods of time (similar to the installation of infrastructure in a new subdivision) as the systems were constructed. [*See* Tr. at p. 56, l. 23 – p. 57, l. 2; p. 471, l. 16 – p. 473, l. 6]. Many of those original installations have now reached the end of their useful life and have to be replaced. Because the infrastructure was installed at the same time, much of it now requires replacing at the same time—significantly eclipsing the resources available to the Company. [Exs. A-9 at p. 14, l. 4 – p. 16, l. 2, A-29, Schneider Rebuttal at p. 6, l. 3 – p. 8, l. 5; Water Loss Reduction Report at pp. 42, 57 (at current replacement levels it would take 640 years to replace existing infrastructure in Superstition division); Tr. at p. 533, ll. 6-24]. The Company made a compelling showing through testimony, studies and samples of the old pipes and facilities themselves that a significant amount of the Eastern Group systems' infrastructure is reaching the end of its useful life much faster than it can be replaced given the resources currently available to the Company. This is not an ordinary event that the Company could have handled differently, and neither Staff nor RUCO have any suggestions as to how the Company could have managed the situation differently given the rates that were awarded in prior cases. Had the Company

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sought to replace this infrastructure prior to the end of its useful life Staff and RUCO would almost certainly have recommended disallowance of those replacements. [Tr. at p. 602, l. 23 – p. 603, l. 1 (Staff considers replacing infrastructure prior to the end of its useful life to be imprudent)]. RUCO's and Staff's arguments that this is not an extraordinary situation and that the Company somehow acted imprudently in not replacing infrastructure that had not yet reached the end of its useful life are not supported by any evidence and do not stand up to any level of analysis. The Company demonstrated that it faces an extraordinary crisis that requires Commission intervention.

2. RUCO's and Staff's Argument That a DSIC Will Reduce the Opportunity to Review the Company's Expenditures on Replacement Infrastructure Conflicts with the Record.

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While RUCO and Staff argue that a DSIC mechanism would reduce the opportunity to review the prudency of the Company's expenditures on replacement infrastructure, neither identifies any specific review or scrutiny that would be curtailed if a DSIC were implemented. Instead, both simply assert, without any support in the record, that a DSIC would result in less review of the plant and expenditures made subject to the DSIC. [Staff Brief at p. 29, ll. 6-21; *see also* RUCO Brief at p. 2, ll. 9-10, p. 5. l. 18 – p. 6, l. 2]. Staff makes vague and unsupported arguments about the constitutionality of the DSIC, but fails to explain how the specific review steps outlined by the Company differ from the accepted ACRM procedures or otherwise do not meet constitutional muster. [Staff Brief at p. 26, l. 17 – p. 27, l. 17]. The evidence in this record establishes that rigorous review consistent with due process and Arizona's constitutional ratemaking requirements can readily be achieved with a DSIC.

First, Staff and RUCO were already provided with an opportunity to review the projects that the Company intends to pursue over the next three to ten years under the DSIC. [Exs. A-28, FKS-13; S-1, Ex. KS at p. 36; Tr. at p. 603, ll. 2-5]. Staff agreed that the proposed projects, as well as the estimated costs for those projects, appear to be reasonable and prudent, [*Id.* at ll. 8-20; p. 611, ll. 2-23], and this testimony underscores the full review opportunities already afforded both parties.

Second, the DSIC would be limited to non-revenue producing replacement plant, such as water mains, service lines, meters and hydrants.[2] [Ex. A-9 at p. 17, ll. 7-17; Tr. at p. 376, l. 25 – p. 377, l. 7; p. 431, ll. 2-11]. The infrastructure to be replaced is already in service and has been fully reviewed and approved in prior rate cases. To the extent the Company replaces a section of a failing water main that is used and useful and currently providing service to customers, Staff and RUCO did not and cannot show how such a replacement could be considered imprudent.

Third, as the Company outlined in its testimony and exhibits, the procedures for its annual DSIC filing for projects that have been completed and placed in service will allow Staff and RUCO the opportunity to fully review the cost and prudency of the replacement infrastructure. [Tr. at p. 376, ll. 7-24]. Finally, during the course of the next general rate case, Staff and RUCO have yet another opportunity to review the cost and prudency of the Company's DSIC-related utility plant replacements before that infrastructure is included in rate base, consistent with the authorities cited in Staff's Brief. [Ex. A-9 at p. 19, ll. 23-27; Tr. at p. 387, ll. 10-19; p. 442, ll. 12-24]. The record conclusively demonstrates that the proposed DSIC will result in a sufficient prudency review, just as the ACRM does, that is consistent with Arizona law.[3]

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[2] As set forth in more detail in the Company's Brief, this feature also mitigates single-issue ratemaking concerns related to allegedly mismatched revenue and expenses or rate of return.

[3] RUCO also asserts, without any evidentiary basis, that a DSIC would incentivize the Company to overspend to keep from meeting its authorized rate of return in order to prevent the loss of the DSIC surcharge. [RUCO Brief at p. 6, ll. 3-15]. That makes no logical sense; moreover, given the Company's inability to earn its authorized rate of return over the last 15 years, RUCO's concerns are purely speculative. Even if the Company had been able to earn its authorized rate of return, the agreed-upon caps on the DSIC ensure that the Company will regularly file a general rate case, during which RUCO will have the opportunity to examine the recorded cost of the Company's infrastructure replacements.

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B. Staff's Remaining Arguments Against the DSIC are Unsupported on This Record and Should be Rejected.

1. The Company's DSIC Proposal is Sufficiently Detailed to Support its Adoption.

Staff spends much of its argument related to the proposed DSIC focusing on the alleged lack of specificity in the Company's proposal. However, that argument disregards all of the Company's testimony, evidence, and filings in this docket and during the hearing. As detailed in the Company's Brief, the mechanics and operation of the proposed DSIC are fully detailed, down to providing examples of the schedules the Company would file should a DSIC be approved. [Company's Brief at p. 18, l. 18 – p. 22, l. 27]. Notably, this was not an issue for Staff prior to or at the hearing of this matter. Staff sent thirteen sets of data requests to the Company. Not a single data request sought additional detail on the operation of the proposed DSIC. Just as telling, Staff presented Mr. Fox to testify about the similarities and differences between the operation of the ACRM and the Company's proposed DSIC. [Tr. at pp. 1416-1450]. Nowhere during his testimony did Mr. Fox say he did not understand the proposed operation and procedures of the DSIC mechanism. Between all the Company's filings and explanatory testimony, its responses to the detailed questions of the Administrative Law Judge and the details provided in the Company's Brief, all legitimate objections to the detailed DSIC mechanism procedures have been overcome in this record.

2. The DSIC is not a Permanent Revenue Enhancer and Does Not Constitute a Mini Rate Case That Will Overburden Staff.

Staff's characterization of the Company's proposed DSIC, as set forth on page 28 of Staff's Brief, is incorrect. Like the ACRM, the DSIC is a mechanism for beginning to recover the costs associated with replacing the aging and failing infrastructure identified by the Company between general rate cases. The plant replacements at issue do not represent new plant to serve customer growth, but instead are replacement of existing infrastructure. [*See* Ex. A-9 at p. 17, ll. 5-17; Tr. at p. 430, l. 15 – p. 431, l. 11]. This plant will become part of the Company's rate base as part of the Company's next general rate case, just as

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replacement infrastructure now becomes part of the Company's rate base at the time of the next general rate case. [Ex. A-9 at p. 19, ll. 23-27; Tr. at p. 442, l. 12 – p. 443, l. 6]. Until that time, the DSIC merely authorizes a necessary monthly surcharge to begin recovery of the costs associated with eligible plant replacements between regular general rate cases. [Ex. A-9 at p. 12, ll. 3-5] That surcharge will be reset to zero when the replacement infrastructure is folded into rate base as part of the Company's next general rate case. [*Id.* at p. 19, ll. 23-27; Tr. at p. 375, l. 23 – p. 376, l. 6]. This is exactly the same procedure followed in the ACRM mechanism.

Like the ACRM procedure it is modeled on, the proposed DSIC does not require a mini rate case. [*See* Staff's Brief dated December 6, 2002 in Docket No. W-01445A-00-0962 at p. 4, ll. 17 - p. 5, l. 15 (explaining that "step increases" allowed under ACRM, on which the DSIC is modeled, are constitutionally permissible and do not require a full rate case hearing); *see also* Tr. at p. 754, ll. 1-6 (RUCO witness Mr. Rigsby recognizing that Staff and RUCO would not conduct a mini rate case on DSIC filings)]. Staff has presented no evidence that the ACRM program imposed any undue burdens on Staff or that the detailed procedures are constitutionally infirm in any way. As a result, the same constitutional presumptions that support the ACRM procedures should apply here as well. [*See* Company's Brief at p. 23, ll. 4-15].

3. Several of the Conditions Proposed by Staff Should be Rejected Because They Undermine the Purpose of the DSIC.

As noted in the Company's Brief, even though Staff remains completely opposed to the DSIC, the Company accepted or already incorporated in its original DSIC proposal most of the conditions proposed by Staff. [Company's Brief at p. 20, ll. 12-14]. Staff proposed three conditions that the Company cannot accept and which should not be adopted: (1) limiting the DSIC to systems with water losses exceeding ten percent, (2) offsetting the DSIC surcharge by a fixed ten percent for hypothetical O&M cost savings, and (3) requiring the refund of any monies collected through the DSIC if the Company is later unable to

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demonstrate that it has reduced water losses in the affected system. Those conditions should be rejected for the reasons already detailed in the Company's Brief at pages 20 through 22.

4. Staff's Proposed SWIP is Unworkable and Should be Rejected.

Staff's proposed alternative to the DSIC, the Sustainable Water Infrastructure Program, or SWIP, should be rejected for the reasons set forth in the Company's Brief. [Company's Brief at p. 17, l. 12 – p. 18, l. 14]. In addition, a review of Staff's Brief confirms that a SWIP would be ineffective in addressing the infrastructure crisis facing the Company. Staff now proposes limiting the SWIP to only two of the Eastern Group's systems, Miami and Bisbee, [Staff Brief at p. 24, l. 17], despite the undisputed issues facing the Company's other Eastern Group systems. Staff would also limit the SWIP to transmission and distribution mains, and exclude the thousands of service lines the Company needs to replace. [*Id.* at l. 18]. In addition, Staff's proposal would not permit any increase in revenues associated with infrastructure replacement until after the Company's next general rate case. [*Id.* at ll. 23-25]. As a result, the SWIP would require more frequent filing of rate cases. Just as importantly, recovery under the SWIP would be disallowed, in whole or in part, if the Company was unable to demonstrate "that the plant replacements contributed to a reduction in water loss…." [*Id.* at p. 25, ll. 3-4]. While the replacement program proposed by the Company should collectively result in a reduction in water losses, the individual projects identified by the Company in this case will likely not have a directly demonstrable impact because so much aging infrastructure is yet to be replaced. [Tr. at p. 552, l. 9 – p. 553, l. 11; p. 624, l. 19 – p. 625, l. 18 (Staff witness Ms. Stukov explaining that proposed projects will not likely have demonstrable impact on water loss initially)]. Even more importantly, as demonstrated in Staff's Brief, the SWIP will not provide any revenue between general rate cases (as does the ACRM) or the credit support needed to address the Company's aging infrastructure problem. Accordingly, the SWIP should be rejected.

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C. RUCO's Remaining Arguments Related to a DSIC are Factually Unsupported and in Direct Conflict with the Evidence Presented.

Rather than addressing the evidence presented to the Commission, substantial portions of RUCO's Brief repeat the arguments and positions of its sister agency in Alaska, the Alaska Attorney General's Office's Regulatory Affairs and Public Advocacy Section ("RAPA"), with respect to DSIC mechanisms implemented throughout the country. Those comments reflect the advocacy of a particularly focused section of the Alaska Attorney General's Office and do not present a balanced view of the DSIC mechanism. As noted by the utilities that responded to RAPA's comments, "the Commission should understand that it is not an even-handed research effort aimed at presenting unbiased information but rather an effort to present information that might undermine the proposed improvements." [Exhibit A hereto at p. 3, ll. 9-11 (Comments filed by the Municipality of Anchorage, Alaska with the Regulatory Commission of Alaska in response to RAPA filing)].[4] RAPA (and RUCO) appear to have ignored and excluded data that was favorable to implementation of a DSIC. [*See id.* at n. 1]. Beyond the obvious biases, an examination of the positions espoused in those materials (and RUCO's arguments) reveal that they are erroneous or irrelevant to the facts and circumstances presented here.

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[4] To the extent that the Commission gives any weight to RAPA's comments, Arizona Water Company requests that the Commission take judicial notice of and equally consider the responsive comments submitted by the Municipality of Anchorage d/b/a Anchorage Water and Wastewater Utility and Golden Heart Utilities, Inc. and College Utilities Corporation to the Regulatory Commission of Alaska in response to RAPA's initial comments. *See* R-11-006, *In the Matter of the Consideration of a Plant Replacement Surcharge Mechanism for Water and Wastewater Utilities*, State of Alaska Regulatory Commission, which can be viewed at http://rca.alaska.gov/RCAWeb/Dockets/DocketDetails.aspx?id=ff6021fb-fb4b-4a11-9e95-557c9a2bca14. A copy of those comments are attached as Exhibit A and B to this Reply Brief. The Company additionally files and urges the Commission to consider the information set forth in Exhibit C, which is a chart prepared by Company witness Joseph Harris that details the facts and circumstances concerning DSIC and DSIC-type mechanisms in other states, as requested by Commissioner Burns at the commencement of the hearing in this matter.

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1. RUCO's Argument That the DSIC Mechanisms in Other Jurisdictions are Unsuccessful is Unsupported and Irrelevant to the DSIC Being Considered In This Case.

RUCO quotes RAPA's biased and shallow research to argue that existing DSIC mechanisms have been largely unsuccessful. [RUCO Brief at p. 8, l. 12 – p. 10, l. 21]. Beyond the obvious point that there is no evidence in the record supporting this argument, a review of the data presented by RAPA reveals nothing of the sort. Twelve states have adopted a DSIC in the past fifteen years. [RUCO Brief at p. 8, ll. 19-20]. RAPA's research concludes that there is little useful data available and that no studies have been conducted on the effectiveness of a DSIC. From this lack of data and studies, RAPA (and RUCO) somehow concludes that DSICs are not effective. The evidence in this record demonstrates otherwise. The actual experience of the Pennsylvania Public Utility Commission shows how well the DSIC works in Pennsylvania. [Company's Brief at p. 13, l. 11 – p. 14, l. 6]. Indeed, in 2011, the Pennsylvania legislature expanded the DSIC mechanism to encompass electric, gas and wastewater utilities. *See* 66 Pa. C.S.A. § 1350, *et seq.*

RUCO's (and RAPA's) reliance on insufficient and contradictory data from other jurisdictions also ignores the realities faced by the Company in its Eastern Group systems here in Arizona, which has different circumstances than those in Alaska. The Company conclusively demonstrated that it faces an economic and infrastructure crisis unlike anything encountered in Alaska. [Company's Brief at p. 6, l. 25 – p. 17, l. 11]. A DSIC would help facilitate the extraordinary capital expenditures facing the Company. [*Id.* at p. 15, l. 11 – p. 17, l. 11]. This is not a case seeking the general acceptance of a DSIC applicable to all utilities in Arizona; it is a case about the specific circumstances facing specific systems operated by Arizona Water Company. Whether or not a DSIC has been approved anywhere else, and whether or not that mechanism has assisted any other companies, the record is clear that it would make a meaningful difference to Arizona Water Company's efforts to finance the replacement of failing infrastructure in its Eastern Group systems, for the ratepayers' benefit. [*Id.*]

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2. The Proposed DSIC Does Not Shift Any Risks to Ratepayers and, in Fact, Benefits Ratepayers and the Company by Mitigating the Negative Effects of Regulatory Lag.

RUCO also argues that a DSIC would shift risks to ratepayers. RUCO's position is inconsistent and unsupported. RUCO (like Staff) is concerned that a DSIC will mitigate the negative effects of regulatory lag. As the Commission is aware, a utility cannot generally recover costs associated with replacement infrastructure until after such plant is included in rate base as part of the utility's next general rate case. This lag in recovery is not beneficial to either the utility or ratepayers. [Exs. A-5, Ahern Rejoinder at p. 5, ll. 7-19, A-34, Ahern Rebuttal at p. 6, ll. 10-15]. For utilities, regulatory lag increases borrowing costs and undercuts their ability to actually earn an authorized return. [*See id.* at p. 6, ll. 10-23]. This results in higher costs to ratepayers as the higher borrowing costs are included in future rates and the utility is forced to file more frequent rate cases to attempt to recoup its costs of service. [*Id.*] Regulatory lag also ensures that utilities time their capital expenditures to coincide with rate cases to minimize the negative impacts of regulatory lag on the utility. [Ex. A-5, Ahern Rejoinder at p. 5, ll. 14-19]. This results in less reliable service and rate shock as investments are made based on rate case timing rather than actual need.[5] [*Id.* at ll. 7-19].

RUCO even trumpets regulatory lag as an important tool to curb unnecessary spending by utilities. [RUCO Brief at p. 3, l. 4 - p. 7, l. 10]. RUCO's position is irresponsible and lacks any evidentiary support, relying wholly on RAPA's position paper. [*Id.*]. Specifically, there is not a scintilla of evidence in the record of any unnecessary spending by Arizona Water Company in its Eastern Group systems. RUCO's argument also contradicts the constitutional requirements of both *Bluefield Water Works* and *Hope Natural Gas*. Under those cases, the Commission is required to set rates that allow for the recovery

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[5] Unfortunately, a DSIC does not eliminate regulatory lag, it only partially mitigates some of its negative affects. Even with a DSIC, the replaced plant is not included in rate base until after the utility's next general rate case, fostering the utilities to operate efficiently and to control costs.

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of costs, including service on debt and appropriate returns on equity. *Bluefield Water Works and Improvement Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679, 693 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Delaying recovery of the costs associated with plant that is in service negatively impacts a utility's ability to earn its authorized rate of return. [Exs. A-34 at p. 6, ll. 16-18, A-5, Ahern Rejoinder at p. 5, ll. 7-19]. Here, the Company has been unable to earn its Commission-authorized rate of return for over 15 years. [Ex. A-10 at p. 5, l. 18 - 6, l. 22; Tr. at p. 332, ll. 7-18]. RUCO's argument that regulatory lag is beneficial seeks to continue to impede the Company's ability to recover its cost of providing service in the misguided name of protecting the ratepayer. This position is especially unjustified given RUCO's acknowledgement of the infrastructure needs facing the Company and its position that the Company should replace that failing infrastructure under the rates that are currently in place.[6]

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A DSIC will provide revenue to support investment in the infrastructure replaced by the Company. However, the revenue collected between rate cases under the DSIC will be credit supportive, allowing the Company to attract the capital necessary to accelerate its infrastructure replacement program on more favorable terms, a critical factor that neither Staff nor RUCO addressed in their briefs. [Ex. A-34 at p. 21, l. 23 – p. 22, l. 1, p. 26, ll. 3-8; Tr. at p. 329, l. 17 – p. 332, l. 18]. Instead of shifting any risks to ratepayers, this will result in long-term benefits to ratepayers as detailed by the Company's witnesses. [*See* Company's Brief at p. 18, ll. 18-23]. It will also more closely match the customers

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[6] RUCO's position also demonstrates why a DSIC should have no bearing on the return on equity eventually set by the Commission. The return on equity requested by the Company will help it to continue its long-standing replacement and maintenance program. But, it will not provide sufficient revenues to lessen the infrastructure crisis facing the Company, which is an entirely separate issue, as demonstrated in the Company's Brief. [Company's Brief at p. 15, ll. 11-23]. A DSIC mechanism to address this problem should play no role in determining the appropriate return on equity for the Company, and the Commission should reject RUCO's attempts to link the two issues.

benefiting from replaced infrastructure with those paying the rates associated with such infrastructure, a principal espoused by RUCO.

3. RUCO's Proposed Conditions Lack Any Evidentiary Basis and Should be Rejected.

RUCO proposes several additional conditions that it believes should be applied to any DSIC adopted by the Commission. Those conditions include: (1) an offset of 15 percent to account for potential, but unknown, future operational savings attributable to the DSIC, [RUCO Brief at p. 17, ll. 6-13], (2) a maximum cap of four percent of system revenue on any DSIC surcharge, [*id.* at ll. 14-17], and (3) inclusion of a revenue adjustment to account for accumulated deferred income tax ("ADIT"). [*Id.* at p. 17, l. 18 – p. 18, l. 11]. As detailed below and in the Company's Brief, these conditions lack any evidentiary basis. [*See* Company's Brief at p. 21, l. 13 – p. 22, l. 11].

With respect to RUCO's arbitrary 15 percent offset, RUCO references the offset imposed by Massachusetts in the natural gas context. [RUCO Brief at p. 17, ll. 10-13]. That offset is based on a per mile computation. [*Id.*, Attachment A § 7.06 (savings "shall equal $2,077 per mile of non-cathodically protected steel mains replaced by the Company …")]. Under that formula, each lineal foot of main replaced results in an approximately $.39 offset, far less than the 15 percent sought by RUCO. As the Company's witnesses noted, any offset must be tied to actual measurable decreases in expenses. [Ex. A-5, Harris Rejoinder at p. 9, l. 13 – p. 11, l. 6]. Unfortunately, RUCO's suggested offset is nothing of the sort. As with Staff's proposed ten percent offset, RUCO's arbitrary offset should be rejected. [Company's Brief at p. 21, l. 13 – p. 22, l. 11].

RUCO's suggested four percent limitation on any DSIC surcharge is also not supported by the evidence in the record. RUCO purports to base its suggested cap on Pennsylvania's initial five percent limitation. [RUCO Brief at p. 17, ll. 14-17]. However, Pennsylvania has since increased its DSIC cap to 7.5 percent. [Ex. A-5, Harris Rejoinder at p. 5, ll. 10-12]. RUCO fails to explain why this higher cap should not apply. Indeed, RUCO does not explain or justify a cap set a full percentage point below Pennsylvania's

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initial five percent cap. Staff and the Company have agreed that a six percent maximum cap, with a two percent annual cap, is appropriate. Accordingly, that cap should be adopted.

Finally, with respect to the ADIT issue, RUCO asserts, again without attribution or basis, that nine jurisdictions that have authorized a DSIC adjust the revenue requirement to address deferred income taxes on DSIC-related plant. [RUCO Brief at p. 18, ll. 7-8 and n. 23]. Of the nine states identified by RUCO, however, only one actually has a DSIC mechanism in place. [*Cf.* RUCO Brief at p. 8, n. 11 (listing states with DSIC mechanisms) and p. 18, n. 23 (states that allegedly address deferred income taxes in their DSIC mechanisms)]. There is little or no support for RUCO's assertion that an adjustment for ADIT should be included in the revenue calculations no more than for the ACRM, which includes no such adjustment.

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D. RUCO's and Staff's Opposition to the Proposed DSIC is Not Supported by Arizona Law.

RUCO states incorrectly that a DSIC is barred by Arizona law as the DSIC is neither an automatic adjustor mechanism nor an emergency request for interim relief. [RUCO Brief at p. 11, l. 1 – p. 14, l. 8]. RUCO's argument, however, simply ignores the existing basis for implementing a DSIC as articulated in the Company's Brief. The Company's proposed DSIC is modeled on the ACRM, a program that the Commission correctly determined is constitutional under Arizona law. As detailed in the Company's Brief, Arizona law allows the Commission wide discretion in designing and implementing rate making mechanisms necessary to address evolving circumstances.[7] [Company's Brief at p. 23, l. 16 – p. 26, l. 16].

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[7] Staff's argument that that a DSIC is unconstitutional under Arizona law directly contradicts the position it took with respect to the ACRM. [*See* Staff Brief dated December 6, 2002 in Docket No. W-01445A-00-0962 at p. 4, l. 17 - p. 5, l. 15 (supporting implementation of an ACRM on the grounds stated in the Company's Brief)]. Staff's arguments regarding the need for more detail for the proposed DSIC, its impact on the Company's rate of return and the lack of exceptional circumstances justifying implementation of a DSIC, [*see* Staff Brief at p. 26, l. 13 – p. 28, l. 17], have been fully rebutted *supra* and in the Company's Brief. [Company's Brief at p. 6, l. 25 – p. 17, l. 11 (extraordinary circumstances), p. 18, l. 18 – p. 23, l. 15 (impacts and mechanism)].

As part of that discretion, the Arizona Supreme Court approved the use of a step increase type mechanism. *See Arizona Cmty. Action Ass'n v. Arizona Corp. Comm'n*, 123 Ariz. 228, 599 P.2d 184 (1979). In that case, the Court considered a multiple step rate increase mechanism that increased Arizona Public Service Company's rates between general rate cases if certain conditions were met. In doing so, the Court recognized that "the adjustments ordered by the Commission [adding certain CWIP to the determination of fair value between rate cases] were adequate to maintain a reasonable compliance with the constitutional requirements…." *Id.* at 231, 599 P.2d at 187.

Here, the Company's proposed DSIC is entirely consistent with those dictates. The "fair value" rate base of the Company's Eastern Group systems will be determined in this rate proceeding. Any DSIC surcharge will be based on annual filings, subject to review by Staff and RUCO and approval by the Commission, that demonstrate the actual cost of constructing that infrastructure and analyze its impact on the Company's authorized rate of return. Importantly, the DSIC is based on the fair value rate base since it relates to replacement of already used and useful plant and is subject to adjustment in the next general rate case. No surcharge could be approved if the system is earning the rate of return set for the Company in this proceeding. Like the increases for CWIP found reasonable in *Arizona Community Action* and the ACRM on which it is based, the DSIC, as proposed by the Company, is constitutionally permissible under Arizona law, and Staff and RUCO have not demonstrated otherwise.

III. THE COMPANY'S COST OF CAPITAL AND RATE OF RETURN SHOULD BE ADOPTED

The parties agree on the cost of the Company's long-term debt and its capital structure. The sole difference relates to the cost of common stock equity.

A. RUCO and Staff's Cost of Equity Positions Are Significantly Flawed and Should be Rejected.

Both Staff and RUCO proposed only a 9.4 percent cost of equity in contrast to the Company's requested 12.5 percent cost of equity. As demonstrated in the Company's Brief,

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RUCO's and Staff's cost of equity analyses are significantly flawed and downwardly biased. [Company's Brief at p. 35, l. 25 – p. 39, l. 2]. As such, their cost of equity recommendations should be rejected.

RUCO, however, now attempts to support its use of a natural gas proxy group by noting that Mr. Reiker, while employed by Staff, used a natural gas proxy group in preparing Staff's recommendation as to cost of equity in one of the Company's previous rate cases. [RUCO Brief at p. 25, l. 11 – p. 26, l. 2]. RUCO ignores the following facts: (1) the Company's position as to the use of a natural gas proxy group has never changed, (2) Mr. Reiker (who did not testify about the cost of equity in this case), while a Staff witness, recognized that the natural gas proxy group had different risk profiles that mandated an adjustment to the cost of equity derived from using such a group, [Decision No. 66849 at p. 21, ll. 16-20], and (3) Dr. Zepp, not Mr. Reiker, contested the use of a natural gas proxy group in this case. These distinctions render Mr. Reiker's position as a Staff witness in a different case years ago irrelevant to the Commission's present determination. As detailed in the Company's Brief, RUCO's reliance on a highly manipulated natural gas proxy group is flawed, has previously been rejected by the Commission, and cannot provide a reasonable basis for setting the cost of equity for the Company. [Company's Brief at p. 36, ll. 7-27].

In addition, RUCO ignores the impact of its own arguments. As RUCO points out, the Commission must consider all relevant factors when determining the cost of equity. [RUCO Brief at p. 26, ll. 6-12]. Those factors include, among other things, comparisons with other companies having corresponding risks, the need to attract capital, the risks of the enterprise and the financial history of the utility. [*Id.*] RUCO's (and Staff's) cost of capital analyses fail to consider all of these factors. [Company's Brief at p. 35, l. 25 – p. 39, l. 2]. RUCO's use of a natural gas proxy selectively excludes companies with comparable risk profiles that would have raised its cost of equity calculation. [*Id.*] RUCO also makes no adjustment to account for the differences in risk between its proxy group and the Company. [*Id.*] Despite clear evidence that the Company's recent financial history, changed capital structure and inability to recover its costs have increased its financial risk and decreased

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ability to attract capital, RUCO and Staff still fail to make adjustments to their respective cost of equity recommendation to address those factors. [*Id.*] For those reasons, RUCO's and Staff's analyses are fatally flawed and must be rejected as unreasonable.

Staff's Brief similarly confirms that Staff's recommended cost of equity is unjustifiably low. Staff's own current market risk premium CAPM estimate is 12.7 percent. [Staff Brief at p. 18, ll. 17-19]. This is higher than Dr. Zepp's recommended cost of equity, yet Staff only recommends a 9.4 percent cost of equity, after averaging their current market risk CAPM with a historical market risk CAPM that is undeniably biased downward by Staff's incorrect use of spot rates for its risk-free rate and an uncontrovertibly low DCF estimate based on inappropriate inputs. [Company's Brief at p. 38, ll. 8-16]. As a result, Staff's cost of equity recommendation should be rejected and the Company's better supported, more reasonable recommendation should be adopted.

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B. The Company's Cost of Equity is Reasonable and Appropriate and Should be Adopted.

Neither Staff nor RUCO have proven that the Company's cost of equity recommendation should be discounted or rejected. Staff argues that Dr. Zepp's cost of equity opinion is flawed because he failed to "update" his cost of equity estimates prior to the hearing. [Staff Brief at p. 19, ll. 12-21]. A review of Dr. Zepp's testimony, however, shows that Dr. Zepp did update his conclusions; he testified that he checked his original opinion in the course of rebutting Staff's and RUCO's cost of equity witnesses' work and confirmed that it remained accurate and reasonable as of the time of hearing. [Tr. at p. 892, l. 11 – p. 896, l. 21]. Because it remained a reasonable estimate of the appropriate cost of equity, Dr. Zepp did not change his recommendation. [*Id.*] As detailed in the Company's Brief, the Company's recommended cost of equity is fully supported, based on appropriate inputs, and more completely accounts for all of the relevant factors facing the Company, including the specific risks facing the Eastern Group systems. [Company's Brief at p. 31, l. 14 – p. 34, l. 13, p. 38, l. 17 – p. 39, l. 2]. For those reasons, the Company's cost of equity recommendation should be adopted.

IV. RUCO'S AND STAFF'S POSITION ON THE REMAINING RATE BASE ISSUES SHOULD BE REJECTED

The positions argued by RUCO and Staff in their respective Briefs on the remaining issues affecting rate base—the inclusion of equity in the calculation of cash working capital and the proposed disallowance of Miami Well No. 17—have been fully rebutted at pages 39 through 41 of the Company's Brief. The Company refers the Commission to the evidence and positions stated there. RUCO's late addition of an argument that the Company's dividend payments, which are crucial to supporting its credit and maintaining a workable capital structure, should be included in the Company's working capital calculation, [RUCO Brief at p. 19, l. 21 – p. 20, l. 8], has no support in the record, is contrary to prior Commission decisions, and is punitive to the Company and its ratepayers.

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The Company further notes that Staff's sole argument for removing Miami Well No. 17 from rate base is a prior Commission decision that plant which had not been actually returned to service should not be included in rate base. [Staff Brief at p. 14, ll. 6-17 (citing Decision No. 71845)]. But that argument does not apply here because neither Staff nor RUCO disputes that Miami Well No. 17 has been returned to service and is, in fact, providing water to ratepayers located in Miami. [Ex. A-29 at p. 12, ll. 6-10; Tr. at p. 605, l. 23 – p. 606, l. 4]. As a result, Staff has no justifiable basis for supporting its contention that the Commission remove utility plant which everyone agrees is in service and used and useful from the Company's rate base.

V. THE COMPANY'S POSITION ON THE REMAINING REVENUE AND EXPENSE ISSUES IS WELL SUPPORTED AND SHOULD BE ACCEPTED

Staff and RUCO argue that the Company's pro forma adjustments to pumping, transmission and distribution maintenance ("T&D") expenses and rate case expenses should be modified or rejected. [Staff Brief at p. 5, l. 19 – p. 12, l. 10; RUCO Brief at p. 20, l. 14 – p. 23, l. 2]. Staff further argues that the Company's proposed adjustments for surging fleet fuel expenses and a Commission decision error in the amortization of certain CAP related charges should be modified. [Staff Brief at p. 5, ll. 6-16, p. 12, l. 15 – p. 13, l. 6]. These positions are unsupported and against the weight of the evidence, as explained in detail in the Company's Brief at pages 41 through 49.

In addition, Staff and RUCO's Briefs cite no support for their arguments against the Company's proposed normalization adjustment of pumping and T&D expenses. While Staff asserts that "there may be other explanations for fluctuations in the reduced cost," [Staff Brief at p. 7, ll. 19-20, *see also* p. 6, ll. 18-19 (reduced expenses "could be the result of factors other than fiscal inability to incur expenses, such as improved operating efficiencies")], Staff provides absolutely no evidence to support that conjecture. As the Company's witnesses uniformly testified, the Company engaged in extensive cost cutting beginning in 2008. [Exs. A-9 at p. 5, ll. 15-25, A-2 at p. 16, ll. 1-21, A-29 at p. 5, ll. 4-9; Tr. at p. 132, ll. 14-25, p. 134, l. 20 – p. 136, l. 1]. Contrary to Staff's assertion that the Company did not provide any examples of routine maintenance that was foregone, Mr. Schneider detailed in his live testimony how the Company has reduced its T&D maintenance expenses, using its valve exercising, painting and hydrant flushing programs as examples. [Tr. at p. 589, l. 19 – p. 591, l. 20].

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Staff's conjecture is also refuted by the undisputed infrastructure replacement crisis facing the Company. The extensive evidence establishing the Company's successful efforts to temporarily reduce its T&D expenses because of the deep recession and financial crisis stands unrebutted in this record. As a result, an adjustment is appropriate to normalize those temporary reductions necessary to enable the Company to return to a level of pumping and T&D maintenance that will ensure the long-term water service reliability. [*See* Company's Brief at p. 42, l. 4 – p. 44, l. 26]. Absent such an adjustment (or under, as Staff refers to it, the "new normal"), [Staff Brief at p. 8, l. 6], the Company will not be able to restore its temporarily curtailed maintenance programs to the level required to properly maintain its systems, which would be detrimental to ratepayers. [*See* Tr. at p. 591, l. 21 – p. 592, l. 2].

RUCO, after initially agreeing with a portion of the Company's proposed normalization adjustment, now urges the Commission to reject any normalization of pumping and T&D maintenance expenses. [RUCO Brief at p. 20, l. 15 – p. 21, l. 21]. In taking that position, RUCO highlights the fact that the Company's administrative and general expenses continued to rise and that the Company continued to pay dividends to its shareholders even as it reduced its T&D expenses. [RUCO Brief at p. 21, ll. 14-18]. As the Company explained at the hearing, the Company's administrative and general expenses increased because of sharp increases in insurance costs and labor-related expenses such as retirement contributions. [Tr. at p. 684, l. 2 – p. 686, l. 5]. The fact that the Company could not reduce these costs has no bearing on whether or not its pumping and T&D maintenance expenses decreased during the relevant time period and should now be normalized. Similarly, the Company's payment of dividends, which has been recognized as necessary and prudent by the United States Supreme Court, *see Hope Natural Gas*, 320 U.S. at 603 (revenue must be sufficient for "the capital costs of the business", including "dividends on the stock"), does not bear upon the question of whether the Company should be allowed to normalize artificially depressed pumping and T&D maintenance expenses incurred during the historical test year. Finally, as the Company's Brief demonstrates, Mr. Reiker's statistical study regarding historical pumping and T&D maintenance expenses was well supported and provides compelling evidence supporting the Company's proposed adjustment, and RUCO and Staff failed to impeach the validity of Mr. Reiker's findings. [Company's Brief at p. 43, l. 9 – p. 44, l. 26].

The Company's proposed rate case expense is also amply supported by documentary evidence and is reasonable. [*See* Ex. A-39]. Contrary to Staff's unsupported argument [Staff Brief at p. 11, 5-14], the Company undertook efforts to control rate case expense. As Staff notes, the Company's in-house counsel "was active throughout this case, including filing the vast majority of the testimonies and other docketed items ...." [*Id.* at ll. 6-7]. That active involvement significantly minimized outside counsel rate case expense. Like Staff, the Company employed two trial counsel during the hearing, dividing the witnesses and subject matters in order the make the presentation of the case as efficient as possible. Each counsel was actively involved in the presentation of the Company's case and their presence permitted the rate case hearing to proceed without interruption despite scheduling conflicts.

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Also, a careful review of each of the Company's witnesses' testimony reveals that they addressed separate facets of the issues, and complimented, rather than repeated, each other.

Staff also argues that the Commission should utilize a 12 month average of gasoline costs ending in April 2012, which indisputably understates the known and measurable expenses the Company is incurring, to adjust for fleet fuel expenses. [*See* Ex. A-5, Reiker Rejoinder at p. 6, ll. 5-11; Company's Brief at p. 45, l. 1 – p. 46, l. 6]. As noted at the hearing, Staff's proposal was significantly below the then-current average price of gasoline. [*Id.*; Ex. S-16]. Because rates should reflect the known and measurable costs of service, Staff's proposed adjustment should be rejected.

Finally, with respect to the Company's proposed adjustment to correct an error in a prior Commission decision relating to recovery of certain CAP charges, Staff argues that the Company should be punished with a longer amortization period because it did not address the Commission's own error promptly enough. [Staff Brief at p. 13, ll. 2-4]. Contrary to Staff's position, correcting the amortization error in the prior Commission Decision does not impose any additional burden on ratepayers, it merely conforms the time frame for the mandated repayment to comply with the time frame originally deemed reasonable and established by the Commission. Accordingly, Staff's position should be rejected and the Company's adjustment adopted. [Company's Brief at p. 49, ll. 3-23].

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VI. THE EVIDENCE IN THE RECORD REQUIRES THAT THE REMAINING RATE DESIGN AND CONSOLIDATION ISSUES BE DECIDED IN FAVOR OF THE COMPANY

The final issues in dispute are consolidation of the Oracle and SaddleBrooke Ranch systems, which RUCO supports, the appropriate rate design, and the adoption of a declining usage adjustment. As detailed in the Company's Brief at pages 49 through 53, Staff's and RUCO's arguments about the declining usage adjustment should be rejected. Similarly, as detailed on pages 53 through 55 of the Company's Brief, Staff's arguments concerning the appropriate rate design and the consolidation of the Oracle and SaddleBrooke Ranch systems are unfounded. Accordingly, the Company's position on both issues should be adopted.

VII. CONCLUSION

Staff and RUCO have failed to demonstrate that the positions advocated by Arizona Water Company should not be adopted in this case. Arizona Water Company has built a substantial record supporting the proposition that now is the time for the Commission to approve a DSIC for the Company's Eastern Group systems and adopt Arizona Water Company's recommended fair value rate base, cost of equity and associated rate of return, and the other approvals sought the Company.

RESPECTFULLY SUBMITTED this 11th day of July, 2012.

ARIZONA WATER COMPANY
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Exhibit A

RECEIVED
By the Regulatory Commission of Alaska on Jun 20, 2012

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

T.W. Patch, Chair
Kate Giard
Paul F. Lisankie
Robert M. Pickett
Janis W. Wilson

In the Matter of the Consideration of a Plant Replacement Surcharge Mechanism for Water and Wastewater Utilities	)	R-11-006

ANCHORAGE WATER AND WASTEWATER UTILITY'S REPLY COMMENTS

I. General Responses

RAPA has chosen to oppose the proposed changes in their entirety rather than suggesting improvements to the Utility Group's proposed PRISM in order to better serve customer/ratepayers. In the face of clearly articulated problems that need solutions (annual general rate case filings, gross under achievement of authorized earnings needed to equity fund plant replacement, hampered ability to fund plant replacement), RAPA steadfastly refuses to provide helpful suggestions for the adoption of any improvements to the process. AWWU does not begrudge RAPA its rights to take any position it deems appropriate with respect to the proposed improvements under consideration in this docket but from the standpoint of the effort to build regulatory processes that address the articulated problems, RAPA's comments are not constructive.

RAPA denies the main regulatory problem this docket addresses choosing instead to extoll the virtues of maintaining regulatory lag. Regulatory lag that this Commission, most regulators and regulated industries see as a serious problem is, in RAPA's view, actually beneficial. It is disturbing to see RAPA openly take this position but RAPA is at least honest about its true purpose. RAPA openly embraces the idea that nominally authorized returns are a sham and should be deliberately undermined in ways that virtually guarantee they cannot actually be earned. At least the Commission can now deal directly with the question of whether it is defensible or desirable to habitually and intentionally delay recovery of actual costs of plant currently in service to customers so as to cause chronic real inability to earn the nominally authorized return. Recovery of actual costs (including a return on equity which is, after all just one of the costs of running a utility) is the object of ratemaking.

The objective is not just aspirational, it is mandatory that rates be set to allow recovery of costs.

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economic management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. *Bluefield Waterworks and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 693, 43 S.Ct. 675, 679, (1923) 67 L.Ed. 1176

The Court has also long recognized the common-sense reason for this:

> From the ... company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt. .. . *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603; 64 S.Ct. 281, 288; 88 L.Ed. 333 (1944).

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To deliberately and actively work to prevent recovery of costs of service in a timely way as RAPA appears to advocate is a completely cynical proposition that the Commission must reject.

RAPA characterizes its comments as presenting the results of a "substantial research project." But in light of RAPA's explicit embrace of preserving regulatory lag as one of its main purposes, the Commission should understand that it is not an even-handed research effort aimed at presenting unbiased information but rather an effort to present information that might undermine the proposed improvements. RAPA declined the offer from Commissioner Giard to attend three days of meetings on the east coast of the United States. Much of the information obtained by RAPA through its research could have been condensed into only a few days and would have been subject to the discussion and mutual understanding of the Alaska utilities, the Alaska Commissioner and the Alaska Commission staff present at those meetings. Instead, RAPA has presented a hodge-podge of incomplete[1] and inconclusive data with which it attempts to discourage the Commission from using the PRISM the Utility Group has proposed. RAPA's conclusions are at odds with the information gathered by the group in attendance at the east coast meetings with utilities, public advocates, commissions and their staff on the east coast.[2]

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[1] AWWU has not attempted to shadow RAPA's work to determine what information RAPA may not have presented but AWWU received a courtesy copy of an email sent by Steve Klick, Executive Policy Manager, Pennsylvania Public Utility Commission, responding to questions from Janet Fairchild in ways that were generally supportive of DISCs but which responses have not been included in the materials RAPA presents to the Commission as part of its "substantial research project."

[2] Indeed, even some of the concerns of the public advocates in attendance at the east coast meetings were alleviated once they were informed that our PRISM proposal requires general rate cases be filed every three years.

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RAPA observes that the data it has found is inconclusive but nevertheless selectively uses it to support its bias against DISC's in general. RAPA's argument against DISCs suffers from a key logical flaw. RAPA concludes that useful data is scarce and it has discovered no useful studies. From this it jumps to its preordained conclusion that DISCs are not a good idea. But this does not logically follow. Simply because RAPA did not find the data to be easily interpreted and did not encounter studies of the impacts of DISCs does not mean that DISCs are not useful. Assuming RAPA is correct that the data are thin or not subject to simple inference, this means only that and nothing more. Moreover, it is easy to understand why there might be no studies of the impacts of DISCs. A well-constructed study involves defensible design, proper data collection according to the study design and analysis of the data. This is expensive and time consuming. Many variables can impact the desired results of less long-term cost, better quality of service, better reliability, less general rate case frequency and more infrastructure investment. Designing a study to determine the impact of a DISC on these outcomes could be challenging and expensive. If one can see the likely benefits of a DISC without an expensive study, such a study may be unnecessary.

Finally, AWWU asks that the Commission focus on the specific PRISM the Utility Group has proposed.[3] The bulk of RAPA's comments pertain to other DISC proposals, the details of which are not necessarily well understood. Only a little over six pages of RAPA's 36 pages of comments are on the PRISM proposed by the Utility Group in this docket. A number of RAPA's criticisms may or may not be appropriate criticisms of other individual DISCs but are not applicable to the specific PRISM proposal the

[3] AWWU draws a distinction between DISCs which it uses as a generic term to refer to various expedited plant investment cost recovery mechanisms and the PRISM which is the specific proposal presented by the Utility Group that is under discussion here.

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Utilities Group has offered. For example, the proposed PRISM does not impose a percentage cap of PRISM-related increases because it instead imposes a requirement of general rate cases every three years. Problems experienced by other programs that may be caused by caps that are too low (e.g. causing more frequent general rate case filings or lack of participation) will not be experienced under the proposed PRISM.

II. Responses to specific RAPA positions

A. The proposed PRISM will reduce frequency of general rate cases, improve quality of service, encourage adequate plant replacement, and address anemic earnings thereby allowing greater equity funding of plant additions

Annual general rate case filings are just the most obvious of a network of associated problems and symptoms of a solvable regulatory problem known as regulatory lag. Ignoring the problem or calling it a benefit, as RAPA proposes, will harm customers over the long run. Under the status quo, well-intending utilities are systematically hampered in their ability to recover for needed investments and persistently disincented from making investments needed to improve longer term costs, service and reliability.

RAPA references a 1999 NARUC endorsement as well as the endorsement of other Public Utility Commissions, showing this type of surcharge would provide for several ratepayer benefits[4] but does not mention the benefits to utilities and their customers. RAPA's distinction between NARUC's endorsement of automatic adjustment charge mechanisms based on customer benefits and regulatory lag is fallacious. They are two sides of the same coin: NARUC's resolution that RAPA attached as Appendix B to its comments lists the ability to recover infrastructure improvement costs on a quarterly

[4] RAPA comments at pp 13-14.

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basis as a presumably favorable attributes. Quite clearly NARUC recognizes that reducing regulatory lag is the object that will pay off in the benefits it perceives in the automatic adjustment mechanism.

AWWU bases its capital investment decisions using essentially the same list of ratepayer benefits that RAPA provides in its quote of the 1999 NARUC endorsement. It is the result of AWWU decisions to invest in its infrastructure for these very customer benefits that require a regulatory mechanism, aside from annual rate case filings, at this time.

B. PRISM should reduce volatility and ease rate shock

RAPA's assertion that "the surcharge's availability generally subjects ratepayers to more frequent rate increases at the expense of rate stability"[5] is unsubstantiated and not logical. Generally speaking, waiting for longer periods of time between rate adjustments – especially during periods of high capital expenditures – makes for larger increases when the general rate case is filed and equates to greater volatility. Passing through smaller increases more frequently and gradually avoids the shock that results from building up larger increases over longer intervals between rate adjustments. For AWWU, because it files annually and would use the PRISM to adjust annually, there would be little difference in volatility of rates under the current annual rate case practice as compared to less frequent general rate cases with annual PRISM surcharge adjustments. However, some regulatory lag would remain under a PRISM adjustment resulting from

[5] RAPA comments at 3.

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the delay of non-PRISM eligible cost increases which would have to wait for a full general rate case filing.

C. PRISM allows full prudency review and facilitates prudent infrastructure investment

RAPA's assertion that the PRISM would result in "jeopardizing assurances that infrastructure costs rolled into rates are prudently incurred."[6] is unsubstantiated and is not accurate. The PRISM very clearly allows full review and scrutiny of all costs included in the utility's rates by operation of the PRISM. Indeed, the PRISM proposes no reduction in opportunity to contest costs on any basis currently available. While it offers a much better process, it denies none of the current bases for review and results in final rates only after ample opportunity for review. Indeed, this is one of the strengths of the PRISM. It results in final rates and does not build up a bow wave of unreviewed projects subject to review of stale facts for projects that have long since been placed into service. Where the Commission determines there is a need to allow a closer review of the specific costs, portions of PRISM filings may be suspended with interim rates put in place to protect all interests.

AWWU's intended use of the PRISM actually would increase the transparency and ability of RAPA to review, scrutinize and criticize AWWU's capital program. AWWU plans to use the pre-review process which would allow RAPA (or any member of the public) to challenge whether the project is eligible to be included in a PRISM. This advance review opportunity will allow the public and RAPA an additional opportunity to see what the utilities are building. This will occur months in advance of

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[6] RAPA comments at 3.

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the actual PRISM surcharge filing. Of course, RAPA does not now review projects on this basis, but even if it decided to embark on these new areas of review, the PRISM would actually facilitate this major expansion of the scope of their review.

RAPA claims that it is "difficult or impossible to track whether DSIC adoption has increased the rate of infrastructure investment."[7] As stated above, it is not clear that RAPA actually wanted to find evidence of success, there are plausible explanations for a lack of studies and, as noted below, even the evidence RAPA has found is often supportive of the PRISM approach. But it is important to look to the incentives of a rate recovery system. If the incentives are against investment because the deck is stacked against full recovery of costs, even the most noble and public spirited investors will be discouraged. Even in the case of not for profit enterprises like AWWU's utilities, if it is difficult to recover rates and the utilities are not permitted genuine opportunities to earn sufficient margins that they can equity fund new plant, it is inevitable that plant investment must decline regardless of how badly it is needed.

D. Alaska Utilities are likely to use the PRISM

RAPA asserts that only two utilities will use a PRISM in Alaska.[8] This is probably not accurate as Doyon Utilities will likely use it. The Utility Group, which represents small, medium, and large water and wastewater utilities agree that a PRISM would be advantageous for all.

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[7] RAPA comments at 3 and 24.
[8] RAPA comments at 4.

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E. PRISM should reduce burdens on the Commission and its staff

RAPA's assertion that "substantial commission resources appear to have been devoted to implementing and administering DSIC-type surcharges in other jurisdictions"[9] is not well-substantiated and is not a fair criticism of the PRISM. In support of this assertion, RAPA describes in its footnote 6 the kinds of things it thinks take additional commission resources. None of those activities are contemplated by the PRISM under discussion here. The footnote cites processes and procedures not recommended by the Utility Group proposal. Indeed, the Utility Group intentionally avoided some of the efforts cited in RAPA's footnote 6 such as the audit and true up; the "incremental to an ongoing replacement program" restriction; the on-site review processes apparently needed in Connecticut and management audits.

F. A three-year general rate case filing requirement should be used instead of a cap and is PRISM is not over-inclusive

Ultimately whether a utility decides to use a surcharge mechanism will depend on how well it fits its needs. For example, AWWU will need the ability to make substantial investments in plant. If a cap is used that impinges on its ability to begin to recover these costs of plant already in service to customers, AWWU will choose annual rate cases as the more efficient and effective means of achieving needed rate changes. This is why the PRISM uses a three-year filing mandate instead of a cap so that the PRISM will be a viable alternative to annual rate cases.

RAPA proposes that a cap should be applied[10] but neither suggests a specific cap nor explains why one is appropriate. The proposed regulation would allow for only

[9] RAPA comments at 4.
[10] RAPA Comments at 5 and 34.

additions that meet a strict standard of having no significant impact on revenues or operating expenses. This is not over-inclusive. To limit the PRISM to specific plant accounts would potentially often limit the PRISM to only components of projects which fall into those specific, arbitrary accounts.

G. Rate of Return does not necessarily require adjustment every year

RAPA complains that the PRISM allows for use of a stale rate of return (ROR) at odds with case law.[11] Of course continued use of the last adjudicated or stipulate return occurs routinely for utilities that do not file general rate cases each year. The PRISM simply follows this longstanding practice of continuing to use the last adjudicated or stipulated return until a new general rate case is filed. Moreover, the PRISM does not prevent the Commission, RAPA or any member of the public from asking that the rate of return be revised at any time. This is true for all utilities all of the time and would not change under a PRISM.

The Commission is currently looking into a fix for the ROR question in docket R-11-004. For the time being, the only rate applicable would be the last approved or accepted rate. To conduct a cost of capital proceeding for every PRISM would create a process no more efficient than annual rate cases and perhaps less efficient for utilities filing more than one PRISM in a year.

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[11] RAPA Comments at 5 and 33. RAPA's reliance on *Glacier State* is at best misleading as that case merely states that a rate of return may be reasonable at one time but become too high or too low over time. The PRISM would provide the ability to update rates by adding some plant costs for plant in service without requiring a full general rate case. It does not prohibit any needed review of the cost of capital.

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H. PRISM will not change regulatory risk

Currently rates can (and in AWWU's case are) adjusted annually. The PRISM allows for much of the rate adjustment that could be received in an annual rate case to be achieved through the PRISM instead. This does not reduce regulatory lag risk as RAPA suggests.[12] It makes rate adjustments much more efficient but it does not reduce the review or frequency of rate relief and for that reason cannot be expected to impact regulatory risk for purposes of determining a utility's cost of equity. It is also true that returns that have not been augmented for regulatory lag risks should not be diminished for reductions in that risk. AWWU's return on equity has not been adjusted upwards by the Commission to compensate for regulatory risk so it would be indefensible to require a reduction to offset augmentation of its return that has never been awarded. For this reason, RAPA's argument that a PRISM fails to account for reduced risk in the proposed DSIC formula[13] should be disregarded.

I. The proposed PRISM is synchronized

RAPA asserts that the PRISM is unsynchronized because it fails to require updated plant accounts and accumulated depreciation.[14] This is not accurate. The PRISM as proposed requires the filing utility to offset plant additions with accumulated depreciation for those plant additions.

The proposed PRISM from the utility group does take accumulated depreciation into account for all projects included in the PRISM. What RAPA appears to suggest is an

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[12] RAPA Comments at 34.
[13] RAPA Comments at 5.
[14] RAPA Comments at 5 and 32.

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adjustment to account for all incremental changes in accumulated depreciation in the utility net rate base. Such a one-sided adjustment would create a monumental synchronization problem which would only be resolved by allowing 100% of rate base additions and incremental accumulated depreciation into the PRISM formula.

AWWU also notes that if the utility is not meeting its authorized rate of return, it is not over collecting revenue from customers.

J. The proposed PRISM does not use cost estimates

RAPA's assertion that the PRISM uses cost estimates without any true-up to actual cost at the time of assessment[15] is a misapprehension of the PRISM. Cost estimates are provided only at the pre-review stage where projects are reviewed for eligibility even though some of them may not be completed or even started. At that time a cost estimate will be provided as background information. At the time the PRISM filing is made the actual known costs (not estimates) of a project will be proposed for inclusion in rates. Thus, for example, if a project has been placed into service, the known costs of that project (assuming it is a PRISM-eligible project) will be proposed for inclusion into the surcharge. If there are costs that are not yet known (say, for example, punch list items for completion that have to be done during the next construction season) they will not be known and will not be eligible for recovery in that PRISM filing.

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[15] RAPA Comments at 5 and 31.

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K. The eligibility test is simple

The PRISM proposes that the utility be permitted to use the PRISM unless it is over-earning. RAPA's assertion that this is "an impossible-to-use test for eligibility"[16] is not believable. The margin or profit is among the most basic and reliable of computations in a utility's financial records. RAPA's citation in its footnote 72 does not appear to contain the quoted language or anything resembling it. But more importantly, the PRISM does not propose that the Commission review each test year to determine what it would have earned as RAPA implies. Rather it is a simple results test proposed to add additional protection to ratepayers against use of a PRISM when a utility is already "over-earning" in excess of its authorized return on equity.

L. If problems in other jurisdictions reduce participation, they do not apply to the PRISM

At page 23 RAPA asserts that the eligible utility use of an available DSIC surcharge shows little wide-spread penetration. The important question is why not. If it is a well-designed program, it should produce benefits for customers in lower regulatory costs and correspondingly more cash available for investment so it would be important to know how to improve participation. RAPA's claimed low level of participation in DISC programs, by itself, implies nothing and is not useful. Assuming it is accurate, without an explanation of why utilities have chosen not to use DISC's there is no valuable or reliable inference to draw from the claim.

The high level of expected Alaska usage undercuts RAPA's criticism that Lower 48 usage is low. The PRISM was designed to fit local Alaska circumstances and should

[16] RAPA Comments at 5 and 32.

be attractive to regulators and regulated utilities alike because it allows the Commission to fully perform its review with full opportunity for RAPA to challenge any inclusions but can be expected to do so much more efficiently. A general rate case is not needed to fully review annual PRISM qualified plant additions. The PRISM process focuses on just the plant additions that are the primary reason for annual rate cases and offers the realistic hope of reducing the frequency of general rate cases.

M. PRISM can be expected to reduce the frequency of Alaska water utility general rate cases

On pages 16-20 of RAPA's comments RAPA suggests that PRISM-like vehicles in other jurisdictions have not reduced the frequency of rate cases. But based on the conversations of the group that visited with East Coast utilities and commissions had with utilities and commission staff, this is simply untrue. Even the citations RAPA provides do not strongly support the conclusion RAPA would like to reach.

RAPA's footnote 33 contains an interesting statement apparently by a utility explaining why it does not use the DISC available to it. The quote cites "The current DISC structure, the quarterly and annual limitations and review process are preventing the program from operating in a beneficial manner. The quarterly DISC surcharges have resulted in frequent and confusing rate changes for customers." There is no reason to believe that the PRISM would suffer from these sorts of problems.

RAPA's footnote 34 shows very encouraging frequency of filings. AWWU must file annual rate cases. According to RAPA research in its footnotes 34 and 35 the utilities under those programs file less frequently than annually which would be a very substantial improvement for AWWU.

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As to Footnotes 36 and 37, one would need to find out why the two utilities both participated in the DISC and filed rate cases every year in order to determine whether there is useful information there. In particular, it would be important to find out whether the more frequent rate case filing utilities were driven to this choice based on surcharge caps set too low or some other structural problem with the DISC in place in that particular jurisdiction.

N. Evidence of increases in water quality or quality of service

At pages 21 and 22 of its comments RAPA asserts there is no showing of an increase in water quality or quality of service due to use of DISCs. This indicates nothing other than perhaps a lack of studies or difficulty of proving causation. But it certainly is intuitively likely that intelligently implementing a plan to replace aging plant as it begins to fail or show signs of age should result in improvements to water quality and reliability of service. Unless someone takes time to create a credible basis for study (design, data accumulation and analysis) there is no reason to expect to be able to easily see conclusive evidence of improvement in water quality or reliability from a DISC. No sign pops up on infrastructure to state "I would have failed if it weren't for DISC."

O. Regulatory lag is not beneficial

Regulatory lag violates the cost causer/cost payer principle by delivering service to customers from new plant but postponing recovery of the actual costs of that plant from customers. It is sometimes unavoidable but where possible, reasonable steps should be taken to avoid regulatory lag. Denying cost recovery for plant investments is a disincentive to invest and claiming instead that it creates "an incentive for companies to

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pursue a more balanced strategy between capital expenditures and O&M expenses"[17] is Orwellian. Does the Commission think that it should push water and wastewater utilities in Alaska to invest less in capital expenditures and more in O&M?[18] If so, on what basis has it reached that conclusion? RAPA has not articulated any basis for believing this is good public policy at this time. What the Utility Group and other jurisdictions regard as a perverse disincentive to invest, RAPA considers a virtue. It is no wonder that RAPA opposes any type of plant cost recovery surcharge.

P. Affordability

AWWU agrees that affordability is an important consideration but not that it belongs in the discussion of the PRISM. Affordability is one of many factors of which management must be aware in making investment and rate recovery decisions.[19] For example, AWWU sometimes does not request rate increases to match the full rates that its revenue requirement justifies. AWWU plans to file rate cases annually whether it be through annual rate cases or PRISM filings. PRISM filings is the more efficient and cost effective approach for both the utilities and the ratepayers. There is also less resulting rate shock for the ratepayers.

RAPA suggests that the Commission consider subsidies in rates for lower income customers. RAPA does not suggest which customers should pay higher rates to fund the subsidy. As the Commission is aware subsidies from one set of customers to another set

[17] RAPA Comments at 25.
[18] RAPA Comments at 26.
[19] At page 27 RAPA says that "AWWU recently projected steep rate increases, even without a surcharge." This shows either ignorance or an effort to mislead the reader. Whatever a utility recovers in a surcharge, it cannot recover in a rate case. To suggest otherwise is, at best, incorrect and the Commission should disregard this inaccurate implication.

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of customers is controversial. AWWU does not support consideration of such as system as part of the Commission's consideration of the PRISM.[20]

Q. Regulations are appropriate to implement a PRISM

RAPA seems set against use of regulations to implement a plant cost recovery mechanism[21] but its reasoning is not convincing. RAPA cites areas of judgment that might be applied in interpreting PRISM regulations on a case by case basis but this does not mean that the same general rule and principles should not be applied to all water and wastewater utilities.

R. Ample time is allowed for review

The PRISM allows for two types of review. On an optional basis, the first review (pre-review) is an annual presentation of projects to be reviewed for PRISM eligibility. Then, regardless of whether the optional pre-review of projects for eligibility has occurred, the mandatory review of the actual PRISM is required. If any issue is raised that requires a hearing, the Commission will establish a schedule for adjudication. Perhaps the first point to note is that the kind of review that might be appropriate of a PRISM (what may be loosely characterized as a prudency review) is not something that occurs very often. Indeed, it is rare for inclusion of the costs of capital projects to be challenged in rate cases. We can reasonably assume based on past experience that future challenges will also be rare. But, in the event that RAPA or anyone else chooses to

[20] AWWU notes that it currently has a Commission-approved program available to eligible customers to receive assistance from other customer donations known as the "Coins-Can-Count" program.

[21] RAPA Comments at 28.

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challenge costs associated with a project, the Commission can establish an adjudicative timeline that is adequate.

III. Conclusion

AWWU asks that the Commission focus on the specific PRISM the Utility Group has proposed. The bulk of RAPA's comments pertain to other DISC proposals, the details of which are not necessarily well understood. In contrast, the PRISM has been carefully designed to effectively address the articulated and serious problems attendant to regulatory lag. The PRISM will allow full and timely review of costs and result in final rates based only on verifiable costs already incurred for plant already serving customers. The PRISM can be expected to reduce regulatory burdens on the Commission, RAPA and filing utilities by reducing general rate case frequency. AWWU asks that the Commission continue its work and propose formal regulations consistent with the PRISM recommended by the Utility Group.

Dated this 20th day of June 2012, at Anchorage, Alaska.

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Exhibit B

RECEIVED
By the Regulatory Commission of Alaska on Jun 20, 2012

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

T.W. Patch, Chair
Kate Giard
Paul F. Lisankie
Robert M. Pickett
Janis W. Wilson

In the Matter of Consideration of a Plant Replacement Surcharge Mechanism for Water and Wastewater Utilities) R-11-006

REPLY COMMENTS OF GOLDEN HEART UTLITIES, INC. AND COLLEGE UTILITIES CORPORATION IN RESPONSE TO COMMENTS OF THE ATTORNEY GENERAL

On behalf of their water and wastewater utility operations, College Utilities Corporation ("CUC"), and Golden Heart Utilities, Inc. ("GHU") provide the following reply comments regarding consideration of a plant replacement surcharge mechanism for water and wastewater utilities.[1] The Attorney General

[1] Order U-11-6(2) refers to the surcharge as a Plant Replacement and Improvement Surcharge Mechanism ("PRISM"). This surcharge mechanism is given different names in other jurisdictions, including a Distribution System Improvement Surcharge ("DSIC"). The Attorney General uses the generic term "DSIC" in their comments and the generic term is used herein in reply to the Attorney General.

asserts it has researched the origin of the Distribution System Improvement Surcharge (DSIC) in Pennsylvania and subsequent implementation of similar infrastructure surcharge programs in various states. However broad this research appears on its face, it is not very deep and provides no analysis or guidance to the Commission about whether similar mechanisms would be appropriate in Alaska with our operational and capital needs. GHU and CUC do not dispute that the surcharge mechanisms allowed in other jurisdictions have been authorized by differing means including but not limited to statutory or regulation changes. GHU and CUC also do not dispute that some utilities have chosen to implement a surcharge mechanism while others have not. However the conclusions drawn by the AG, based on this research, are somewhat misleading or irrelevant to the discussion and fail to address the underlying need for a plant replacement surcharge mechanism for water and wastewater utilities in Alaska.

SUMMARY OF COMMENTS

The Utility Working Group identified issues with the current rate case filing process and crafted a proposed regulation for discussion. The Attorney General makes several claims in opposition to the Utility Group's position paper and suggested regulations based on the research conducted by their staff. These claims include:

1. There is little evidence showing DSIC adoption has led to a reduction in rate case frequency or rate case expense.[2]
2. The majority of DSIC-eligible utilities do not use the surcharge.[3]

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[2] *Comments of the Attorney General*, page 3, at line 10.

[3] *Comments of the Attorney General*, page 3, at line 16.

3. Only two large water and wastewater utilities are expected to use the surcharge in Alaska.[4]
4. DSIC adoption circumvents ratemaking safeguards to the detriment of the ratepayer.[5]
5. It is unlikely that a DSIC could be administered in Alaska without increased administrative costs.[6]
6. The Utility Group's proposed regulation is seriously flawed.[7]

GHU and CUC address each individual concern below.

DISCUSSION

1. There is little evidence showing DSIC adoption has led to a reduction in rate case frequency or rate case expense.

GHU and CUC agree that, based on the data the Attorney General described from other jurisdictions, the results can be said to be mixed or inconclusive as it relates to whether adoption of a DSIC leads to a reduction in rate case frequency.[8] The Attorney General's review of other jurisdiction's rate case filing frequency appears to be limited to how often a utility filed a rate case before and after implementation of a DSIC type program. To properly assess whether a DSIC mechanism results in a reduction in rate case frequency or rate case expense requires a much more in depth analysis of the rate drivers of a

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[4] *Comments of the Attorney General*, page 4, at line 1.

[5] *Comments of the Attorney General*, page 4, at line 9.

[6] *Comments of the Attorney General*, page 5, FN 7.

[7] *Comments of the Attorney General*, page 5, at line 3.

[8] *Comments of the Attorney General*, page 20, at line 10.

particular utility or whether the jurisdiction had other regulatory mechanisms to ameliorate the effects of regulatory lag (i.e. forward looking test year). It does not appear that this type of analysis was done. Therefore, drawing any conclusions from other jurisdictions and the applicability or comparison to utilities in Alaska is misleading and could be irrelevant.

To stand by idly while utilities continue to file almost annual rate cases demands consideration of a regulatory change. The Commission has found,

> The record in this case has convinced us that to just stay the course and wait for GHU/CUC to file yet another costly rate case would not be in the public interest. GHU/CUC customers will be better served by dollars spent on improving the plant and services of the Utilities than on litigating rate cases.[9]

It cannot be overlooked that the utilities are charged with the responsibility of prudent management of the assets. Prudent management requires continual assessment of the plant in service to the ratepayer through development of a long-range infrastructure improvement and replacement plan. For GHU and CUC the planned level of annual investment totals approximately $8 million. GHU and CUC's utility plant is highly leveraged, that is, the utilities have a low percentage of net earning plant, compared to gross plant in service. This is due to high percentages of depreciated plant and contributed plant, and plant that has been disallowed for ratemaking purposes. As a result, while GHU and CUC bear the risk of managing and replacing these assets, the existing rates do not capture the true cost of service because there is no depreciation expense or return included in existing rates associated with the plant being replaced.[10] The new plant is replacing existing plant, and is not a result of adding customers. Therefore rates

[9] Order U-07-76/77(8), p. 76.

[10] GHU/CUC fund much of their capital plan by reinvesting depreciation expense.

will increase for existing customers because the utilities do not generate new revenue associated with the new plant in service.

The issue, plain and simple, is should the utility be required to file almost annual rate cases in order to recover the costs of plant that has been placed in and provides service to the ratepayer? The Utility Group's proposed regulation considers the frequency of rate cases and defines a mechanism that, if implemented, will allow the utility to recover the actual costs of plant placed in service to the benefit of the customer in an effort to avoid annual rate cases.

2. The majority of DSIC-eligible utilities do not use the surcharge.

The Attorney General claims "a total of approximately 693 utilities are eligible to use a DSIC-type surcharge, but research shows only 34 (4.9%) have done so. Of those using a DSIC, the bulk (about 60%) are owned, in whole or in part by one the nation's four largest water companies."[11] What is not discussed, however, is if there are any barriers in the particular mechanisms adopted, e.g., do the jurisdictions that have the mechanisms include additional regulatory restrictions that limit the utility of the mechanism? It is foreseeable that notwithstanding a DSIC, if the jurisdiction includes a rate cap that is too low to allow for the predictable growth of the utility, a rate filing would be needed. If the jurisdiction includes a narrow definition of the types of plant included, it is foreseeable that notwithstanding a DSIC mechanism, a rate filing would be needed.

GHU and CUC do not presume to guess the relevance of the use of DSIC mechanisms in other jurisdictions to whether the Commission should consider a

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[11] *Comments of the Attorney General,* p. 22 and 23. This characterization as "large" water companies is incorrect. For instance, Utilities, Inc. is a parent company of 77 small water companies, and in the aggregate, all 77 companies have only 250,000 ratepayers, for an average size utility of 3,250 ratepayers.

DSIC mechanism in Alaska. The fact is, the mechanism has been successful in other jurisdictions. Contrary to the Attorney General's implication that DSIC has been a failure, in 2011, Pennsylvania expanded its application from water utilities to include electric, gas and wastewater utilities in Pennsylvania.

Before implementing a DSIC mechanism it is important to determine whether the mechanism will provide the intended results. The Attorney General notes that a DSIC mechanism was implemented in California on a pilot basis and was later discontinued. More to the point and to provide a full relevant explanation, the California Public Utilities Commission allowed the DSIC, California American Water requested to discontinue the DSIC program because the quarterly and annual <u>limitations (caps) and review processes</u> prevented the program from operating in a beneficial manner. In supporting the discontinuance, the California Division of Ratepayer Advocates noted that DSIC may be more appropriate for jurisdictions that utilize a historic test year, rather than the prospective future test year regulation used in California.[12] In California, the intended results were not achieved because of the quarterly and annual limitations (caps). Regulatory lag coupled with use of a historic test year, which drive our utilities' needs for a DSIC mechanism, distinguish the potential use of a DSIC in Alaska from the limited use and related failure of a DSIC (with caps) in California.

The water and wastewater utilities in Alaska strongly support consideration of a DSIC mechanism. However, GHU and CUC would note that a barrier to finding a DSIC mechanism useful can be tied to whether the intended result is achieved. Too many restrictions (rate caps, limiting plant investment types etc.) outweigh any benefits achieved and thus the utilities would continue to file rate cases regardless. For that reason, the Utility Group has considered the caps and

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[12] *See* <u>http://docs.cpuc.ca.gov/efile/MOTION/141195.pdf at page 305</u>, Sec. 11.7

limitations that can limit the effectiveness of a surcharge mechanism. Therefore, the proposed regulation does not include limitations but rather requires a utility to file a rate case within three years of implementing a surcharge. The ratepayers are protected from paying excessive rates because the surcharge will be reviewed and will only recover **actual** costs of plant placed in service that is to the benefit of the ratepayer. In addition the utility is required to file a rate case within three years of implementing a surcharge, thereby ensuring that rates will not go unchecked for excessive periods of time.

3. Only two large water and wastewater utilities are expected to use the surcharge in Alaska.

The Attorney General asserts that only two "large" water and wastewater utilities[13] would use the surcharge in Alaska with any regularity. This is incorrect. There are six Class A water utilities (AWU, GHU, CUC, DU-FWA, DU-FGA, DU-FRA)[14]. There are six Class A wastewater utilities (ASU, GHU, CUC, DU-FWA, DU-FGA, DU-FRA). As reflected on the recent budgetary disclosures in the RCC dockets,[15] these utilities account for about 99% of the Water and Wastewater industry revenues upon which the budget of the Commission and the Attorney General is recovered through the RCC rates. All twelve of the Class A utilities anticipate ongoing and large capital replacement projects that would drive the need to file annual filings. Such utilities could utilize a DSIC mechanism to delay the need for general, and expensive, annual rate filings. That the utilities that

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[13] *Comments of the Attorney General*, page 4, at line 1 and FN 4 identifying the utilities as Anchorage Water & Wastewater Utility (AWWU) and Golden Heart Utilities/College Utilities Corp. (GHU/CUC).

[14] Although DU-FGA reported 2011 revenues are less than $1,000,000, the recently filed revenue requirements indicate an increase to revenues in excess of $1,000,000.

[15] U-12-067(1)/P-12-006(1).

consume a large percentage of state regulatory resources could offset this resource consumption through a DSIC mechanism is a strong public policy argument in favor of considering such a mechanism, so long as it is appropriately balanced, a balance that is included in the proposed regulation filed by the utilities.

The Attorney General also asserts a "one-size fits all" approach may not be relevant to Alaskan utilities and suggests instead to address the necessity of implementing a surcharge in individual adjudicatory dockets. In reading this position, GHU and CUC were incredulous. In U-11-77/78, GHU and CUC asked for a simplified filing procedure that would have included capital improvements. The Attorney General actively opposed this utility-specific relief, arguing that singular treatment would be unfair and the mechanism is being more appropriately considered in a rulemaking docket. The Attorney General successfully moved to strike utility-specific relief it now advocates here. See Order U-11-77/78(10). The AG's argument now is inconsistent with its position then, and should undermine its claim on the point.

GHU/CUC object to this position on other grounds. First, a regulation could address overarching processes while providing consideration to individual utility (large or small) circumstances. Second, where the utilities are asking for regulatory certainty, this cannot be achieved where the adjudicatory process is subject to regulatory lag and is subject to the changing position of Interveners from case to case, as discussed above. Finally, establishing a process through individual adjudicatory dockets is time consuming and expensive, and could lead to disparate treatment of like entities, or require duplicative efforts of Commission staff.

4. <u>DSIC adoption circumvents ratemaking safeguards to the detriment of the ratepayer.</u>

The Attorney General claims that a surcharge mechanism can easily sidestep the safeguards of regulatory oversight while creating a substantial danger that consumers will be saddled with excessive rates.[16] The Attorney General further claims that regulatory lag is the only regulatory tool available to protect the captive ratepayer.[17] Finally, the Attorney General suggests that any consideration of a new surcharge should also give some consideration to affordability.[18]

What the Attorney General overlooks is that the plant proposed to be included in a DSIC is plant that is used and useful, and currently providing service and value to customers. GHU and CUC agree that safeguards should be in place to ensure that the rates charged are just and reasonable; those safeguards are well established and include that plant is used, useful, and *prudent*. The Utility Group's proposal does not circumvent the ratemaking safeguards, but rather provides a balanced approach to ensuring that the rates charged are reasonable and adequate to cover the costs of providing service while ensuring the required opportunity to earn the allowed return on investment devoted to the public use.

It is not denied that regulatory lag is inherent in every rate case. That does not mean that regulatory lag is per se reasonable. Indeed, regulatory lag alone could be the basis for a claim of confiscation of capital and unreasonable rates. GHU and CUC vehemently disagree with the Attorney General's implication that complaints about regulatory lag are addressed by the Commission's allowance of interim rate relief.[19] The Commission's current

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[16] *Comments of the Attorney General*, page 24, at line 3.

[17] *Comments of the Attorney General*, page 24, at line 17.

[18] *Comments of the Attorney General*, page 28, at line 8.

[19] *Comments of the Attorney General,* p. 26.

practice when allowing interim rate relief requires a utility to choose between paying interest on refunds at a hefty 10.5%, (the statutory cap in AS 45.45.010(a)), or place the interim revenues received in an escrow account with interest paid to the customer at the rate earned by the escrow fund (rates are currently approximately 0.15%). To avoid paying interest at 10.5%, many utilities are opting to place the interim revenues collected in an escrow account. These revenues are therefore not available to the utility to fund the necessary operating and capital costs of utility services to its customers while the rate case is pending. GHU and CUC, which elected to escrow interim revenues received to avoid the 10.5% interest rate in the most recent rate case,[20] were required to increase borrowing to fund utility operations while the rate case is pending and interim and refundable rates are in effect. The fees associated with increased debt increases the cost of utility service to our customers. This practice is contrary to the purpose for granting interim and refundable rate relief and does not mitigate the regulatory lag as claimed by the Attorney General. Indeed, the practice increases the cost of providing service to customers, a cost that ultimately will be borne by customers.

The Attorney General also relies on statements in past APUC orders that are thirty years old[21] to justify arguments opposing surcharge mechanisms. This reliance on old cases is misplaced and fails to recognize more recent Commission precedent conceding that surcharge mechanisms may be appropriate to enable utilities to avoid annual filings. For instance, the Commission has allowed recovery of energy related costs that are largely outside

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[20] U-11-077/078.

[21] In re: Homer Electric Association, Order U-83-74(7) at 15. "Moreover, it should not be forgotten that surcharges even in fuel and wholesale power situations are not well receive of late (if ever), principally because their presence reduces incentives to minimize or offset costs increases." Since this order issued, of course, the Commission has promulgated regulations to allow surcharges for electric utilities. 3 AAC 52.503.

the control of a utility through a surcharge mechanism.[22] For GHU and CUC, having a cost flow-through mechanism has heightened our awareness of "flow through" costs and served as an incentive to control steam usage and reduce costs through effective and efficient management during the winter months. Our heightened awareness of costs that are directly borne by our customers has incentivized GHU/CUC to be more protective of our customer interests.[23]

Finally, the Attorney General suggests that "affordability" is relevant to the issue of whether DSIC should be adopted here. GHU and CUC disagree. First, affordability is already considered by GHU/CUC in development of the utilities' current and long-range capital plans. In addition, the utility actively pursues low interest rate funding and grants where and when available.[24]

It is well established that rates must be just and reasonable, and sufficient to allow the utilities to attract capital and an opportunity to earn a fair return on equity. Nowhere in the regulatory compact is there a requirement of "affordability." Indeed, the contrary is implied because the cost causer must be the cost payer, and utilities cannot subsidize one class of ratepayers in favor of another or violate the restriction against discriminatory rates. If rates are artificially lowered for one social class of customer, rates must be increased for or subsidized by another class of customer.

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[22] See U-07-076/77(8).

[23] See U-10-058 (Aurora Energy deregulation petition, intervening on behalf of customers who will pay costs of deregulated steam under the flow through mechanism).

[24] See generally, U-07-76/77 (GHU/CUC unsuccessfully seeking inclusion of lobbying expenses where lobbying successfully ensured access for private water companies to low-interest government subsidized Safe Water funds.). GHU/CUC testify as to consideration of affordability in capital planning in each rate case.

> Poverty is intolerable and private charity never suffices, so government steps in. But helping the luckless should be done by political leaders, who must justify their actions to the electorate; not by professional regulators, whose focus must be industry performance.[25]

Management is charged with prudently operating the utility to provide safe and reliable service. That is our duty. "Affordable" rates would be purchased at the expense of the regulatory compact, and would not be in the public interest.[26]

The Utility Working Group drafted a regulation that allows a flow through of **actual** costs to the ratepayer between rate cases. Prudent management of utility infrastructure requires planned replacement and continued robust investment. In order to attract the capital necessary, barriers to investing must be removed. Surely the Attorney General is not suggesting that a utility forego needed infrastructure investment in order to manage costs. To do so would not be prudent. A DSIC surcharge mechanism as proposed would encourage investment while providing assurance that the rates charged are just and reasonable because only actual infrastructure investment costs to provide the service to the ratepayer are included in the surcharge rate.

5. <u>It is unlikely that a DSIC could be administered in Alaska without increased administrative costs.</u>

Whether a DSIC could be administered in Alaska without increased administrative costs is highly dependent on the level of limitations implemented, along with review and reporting requirements. If the surcharge mechanism is effective, it most likely will result in fewer annual rate filings. If these utilities are allowed a surcharge mechanism and avoid annual filings, the savings in

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[25] *Effective Regulation of Public Utilities*, Scott Hempling, http://scotthemplinglaw.com/essays/affordable-utility-service-what-is-regulations-role.

[26] The focus on "affordable" rates by the City of Fairbanks resulted in a vastly undercapitalized and unmaintained utility, as the Commission is well aware.

resources will eclipse the administrative cost of reviewing the surcharge documentation. As proposed, a utility could file a DSIC surcharge no more than two times per year. Fewer annual rate case filings would help offset the cost of monitoring and reviewing a DSIC surcharge. Further, if the surcharge mechanism is not effective and utilities are still required to file annual rate cases, we will be in no worse position than we are today.

GHU and CUC would caution against placing a higher threshold of review for a DSIC than is currently experienced during the rate process, under the guise of providing additional assurances that the costs are prudently incurred. Where water and wastewater utilities currently file almost annual rate cases, and where the current level of review of infrastructure investment costs is minimal, one may conclude that these costs were prudently incurred and the approved rates were just and reasonable. GHU and CUC maintain that administrative costs will continue to rise if utilities are not afforded a simplified surcharge mechanism as history has already proven that almost annual rate increases are a reality, and not a mere threat.

6. <u>The Utility Group's proposed regulation is seriously flawed.</u>

The Attorney General claims that the Utility Group's proposed regulation contains five (5) flaws,

- Cost estimate is used to set surcharge

RESPONSE: The Attorney General is mistaken. The proposed regulation section 3 AAC 48.276 (c) (2) specifically states "The filing must list the projects on which the PRISM is based and include actual project costs for inclusion in the PRISM for plant in service to customers as of the proposed effective date of the PRISM surcharge." A PRISM surcharge will include only actual costs incurred for plant placed in service to the benefit of the ratepayer.

- DSIC eligibility is impossible to meet

RESPONSE: The Utility Group proposal includes an "earnings test" to demonstrate that the utility did not over-earn its authorized return on rate base. Many jurisdictions have implemented this type of reasonableness check and a similar mechanism in Alaska would not be impossible as the Attorney General claims. Ratemaking is not an exact science. Therefore establishing a formula which provides a reasonable, but not exact, assurance that the utility is not over-earning is possible.

- DSIC formula is unsynchronized

RESPONSE: The Attorney General claims that the DSIC formula is not synchronized because it does not update the rate base amounts to account for plant retirements or accumulated depreciation since the prior rate case. GHU and CUC disagree that adjustments to this degree are necessary. First, more likely than not, the utility is currently earning on a 13-month average of plant in service that most likely is less than the actual net plant valued on a year-end basis. The design principle is to reflect recovery on and of *incremental* investment. Second, adjusting plant in service for retirements and accumulated depreciation for all of the utility plant in service, as suggested by the Attorney General, and in turn limiting the type of DSIC eligible plant in service to include in rates leads to a situation even more "unsynchronized." Finally, the purpose of DSIC is to add the cost of plant placed into service without having to file a general rate case. Any other "offset" serves to reduce the effectiveness of the mechanism. Depending on the surcharge limitations, it is more likely than not that a utility will invest more in infrastructure than can be recovered through the DSIC mechanism, thereby balancing any areas that may appear to be unsynchronized during the period between rate case filings.

- DSIC formula improperly uses a utility's previously approved ROR

RESPONSE: Using a utility's previously approved ROR is a reasonable solution to avoid annual rate case filings. For a large utility it is more likely than not that they will have filed a rate case within the last two years and the ROR is relatively current. Rate stability and regulatory certainty to encourage investment should include the utility's previously approved ROR without incurring the expense of further litigation.

GHU and CUC disagree that the ROR should be reduced to reflect a reduced risk as suggested by the Attorney General.[27] Despite repeated requests that the Commission do so, and in the face of active opposition of the Attorney General to an upward adjustment, the ROR in Alaska has never been adjusted to reflect an increased return for the risk of regulatory lag and therefore the ROR should not be reduced here. Implementation of a DSIC surcharge is not a risk reducer, but rather is a penalty eliminator. The current system acts as a disincentive to investment between rate cases. The DSIC surcharge mechanism would remove or eliminate that disincentive to invest. Further, utilities should not be penalized for investing now where water and wastewater utilities are currently not earning the authorized returns. See EXHIBIT A.

- DSIC proposal is over-inclusive in the plant allowed

RESPONSE: The Utility Group proposal was crafted to not overly exclude the types of plant that could be eligible for inclusion in DSIC. As discussed earlier, limiting the types of plant could cause the DSIC mechanism to be ineffective.

For example, GHU and CUC reviewed their 2012 capital plan and applied the limitations (eligible cost elements) initially described by R-11-6(1) Appendix B. The 2012 capital plan totals $7.8 million. Of this amount, $52,000 is for new service that would not be included in a DSIC surcharge. Only $2.1 million meets the eligible cost elements described in Appendix B. The largest single item in the 2012 capital plan, $4.6 million to replace the sludge dewatering presses and

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[27] *Comments of the Attorney General*, p. 34

construct a new remote dewatering/compost mixing facility, would not be eligible for DSIC recovery under the limitations of the initially described eligible cost elements. A capital infrastructure investment of this magnitude would be sufficient to drive a rate case filing. If only $2.1 million of a $7.8 million budget is eligible for inclusion in a DSIC surcharge mechanism, the mechanism would be ineffective and would result in the utility filing a full rate case.

Further, the Attorney General claims that the surcharge's allowed scope should be narrowly tailored to specifically achieve a legitimate *ratepayer benefit.* This is a flawed premise that is irrelevant if the plant investment is prudently incurred, if the investment is not disputed, and where the investment currently is providing service to the customer. Prudently incurred implies there is a legitimate ratepayer benefit; otherwise the cost could never be included in rates whether through a surcharge mechanism or a rate case filing.

CONCLUSION

GHU and CUC appreciate the opportunity to provide comments and input regarding developing a regulation to allow water and wastewater utilities to implement a plant replacement surcharge mechanism. The proposed ratepayer protections include an opportunity to review the capital infrastructure investment plans and actual costs to ensure the plant is used and useful. Charges will be billed to customers only after the utility has made the associated investment. Additionally, if the utility's earned rate of return exceeds its allowable rate of return, the DSIC is reset to zero. Finally, during the utility's next rate case, the additions to plant, covered by the DSIC, are included in rate base and the DSIC is reset to zero. These important safeguards are designed to ensure that the surcharge mechanism is effectively monitored and that the plant is used and useful to the benefit of the customer. A surcharge mechanism will address regulatory lag and encourage a measured approach to utility plant investment and rehabilitation and more likely than not will expand the time between rate case filings which will reduce rate case costs that are ultimately borne by the customer.

DATED this 20th day of June, 2012, at Fairbanks, Alaska.

GOLDEN HEART UTILITIES, INC. AND
COLLEGE UTILITIES CORPORATION,

/s/ Kristen Winters

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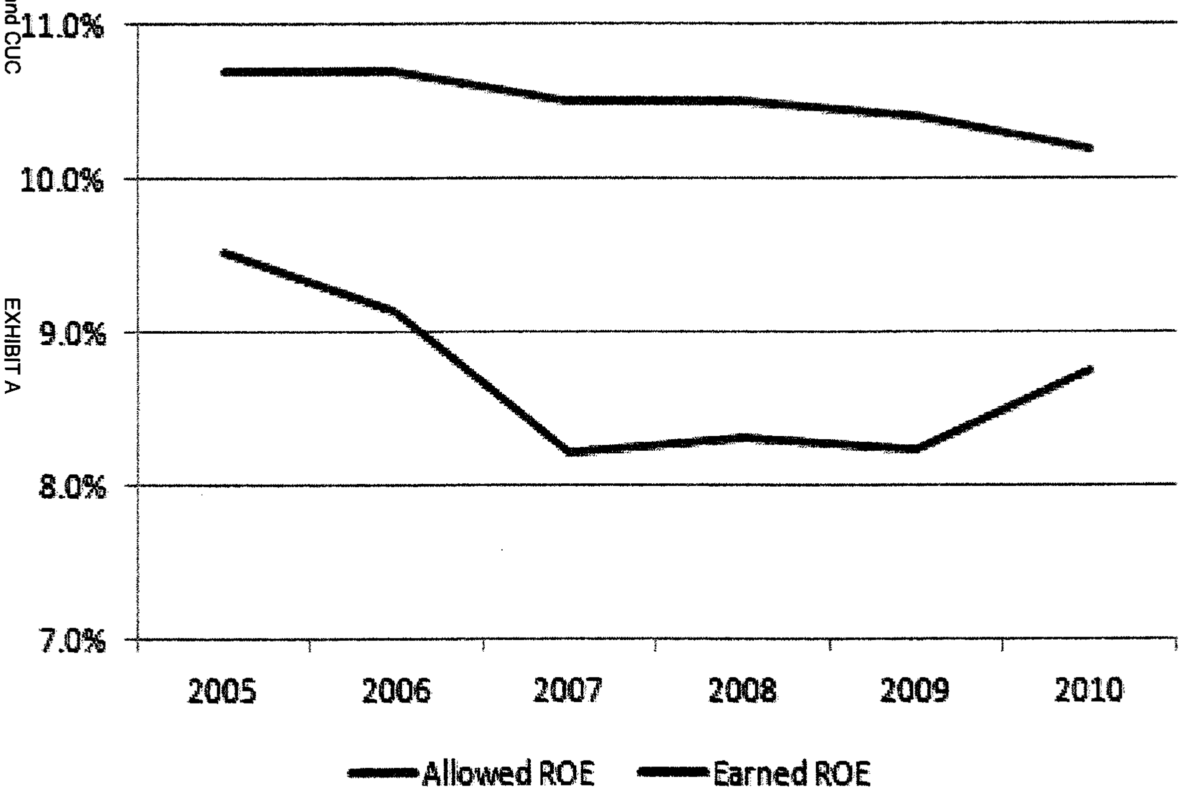
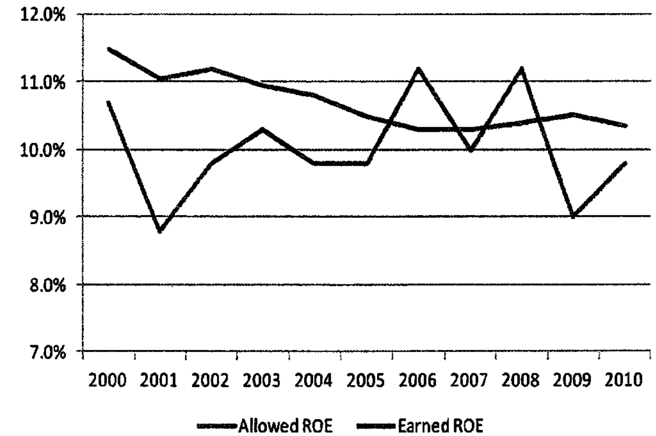
Return on Equity (ROE)
Allowed vs. Earned Comparison

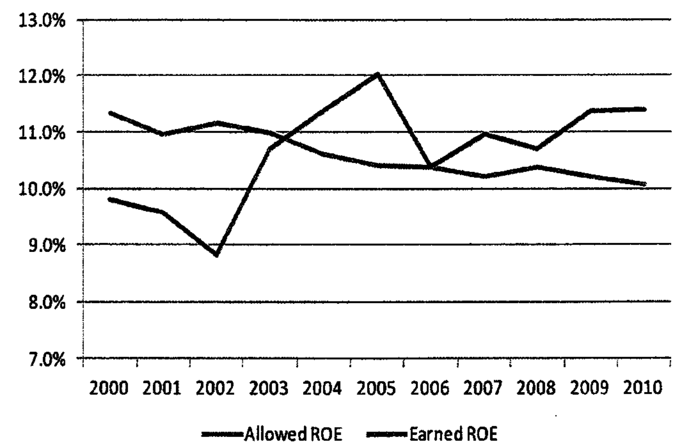
Water Utilities



Electric Utilities



Natural Gas Utilities



Source: SNL Energy, RW Baird

Exhibit C

Line No.	State	Availability	Circumstances Where Used	Program	Year Enacted	Purpose	Return used to Calculate Revenue	Depreciation	Filings
1.	Pennsylvania	Water	Utilities must submit initital application, testimony and exhibits justifying surcharge	Distribution System Improvement Charge (DSIC)	1996	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Quarterly
2.	Illinois	Water and Wastewater	Utilities must submit initital application, testimony and exhibits justifying surcharge	Qualifying Infrastructure Plant Surcharge (QIP)	2000	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Quarterly
3.	Indiana	Water	Utilities must submit initital application, testimony and exhibits justifying surcharge	Distribution System Improvement Charge (DSIC)	2000	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Annually
4.	Delaware	Water	Utilities must submit initital application, testimony and exhibits justifying surcharge	Distribution System Improvement Charge (DSIC)	2001	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Semi-annually
5.	Ohio	Water and Wastewater	Utilities must submit initital application, testimony and exhibits justifying surcharge	System Improvement Charge (SIC)	2003	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Annually
6.	Missouri	Water (St. Louis County only) and Gas	Utilities must submit initital application, testimony and exhibits justifying surcharge	Infrastructure System Replacement Surcharge (ISRS)	2003	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Semi-annually
7.	New York	Water	Case by Case	Distribution System Improvement Charge (DSIC)	2005	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Semi-annually
8.	Connecticut	Water	Utilities must submit initital application, testimony and exhibits justifying surcharge	Water Infrastructure and Conservation Adjustment (WICA)	2007	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Semi-annually
9.	California	Water	Pilot program (case by case)	Infrastructure System Replacement Surcharge (ISRS)	2007	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Quarterly
10.	New Hampshire	Water	Pilot program	Water Infrastructure and Conservation Adjustment (WICA)	2009	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case	Calculated using approved rates less plant retired	Annually
11.	New Jersey	Water	Utilities must submit initital application, testimony and exhibits justifying surcharge	Distribution System Improvement Charge (DSIC)	2012	Allow recovery of a return on and depreciation expense related to investment in distribution system improvements	Weighted Average Cost of Capital determined in last rate case (cost of debt updated)	Calculated using approved rates less plant retired	Semi-annually

Line No.	State	CAP Annual	CAP Overall	Earnings Test	Separate Tariff	Notice to Customers	Hearing Required	Plant Limit	Surcharge Reset to Zero in Next Rate Case
1.	Pennsylvania	7.5%	7.5%	Yes	Yes	Yes	No	Non-revenue producing: Mains and valves (including cleaning and relining and elimination of dead-end mains and costs of relocations due to street or highway construction), hydrants, services, meters	Yes
2.	Illinois	5.0%	5.0%	No	Yes	Yes	No	Non-revenue producing: Mains (including elimination of dead-end mains and costs of relocations due to street or highway construction, hydrants, services, meters Wastewater: Force and Gravity Collecting Sewers (including costs of relocations due to street or highway construction), Services	Yes
3.	Indiana	5.0%	5.0%	No	Yes	No	Yes, within 60 days of filing	Distribution mains, valves, hydrants, service lines, meters, meter installations and other appurtenances	Yes
4.	Delaware	5.0%	7.5%	Yes	Yes	Yes	No, 30 day review by Commission Staff	Non-revenue producing: Mains (including elimination of dead-end mains and costs of relocations due to street or highway construction), hydrants, services, meters	Yes
5.	Ohio	3.0%	3.0%	Yes	Yes	Yes		Non-revenue producing: Mains (including elimination of dead-end mains and costs of relocations due to street or highway construction, hydrants, services Wastewater: Lift stations and mains (including costs of relining and cleaning and relocations due to street or highway construction); Land and land rights aquired as necessary for any service line, equipment or facility covered by this tariff.	Yes
6.	Missouri	10.0%	10.0%	No	Yes	Yes	No	Mains (includes cleaning, relining and costs of relocations due to street or highway construction), valves and hydrants	Yes
7.	New York	Company specific capital expenditures	Company specific capital expenditures	No	Yes	No	No, 60 day review by Commission Staff	Distribution or transmission mains (including cleaning or relining of mains), valves, services and hydrants	Yes
8.	Connecticut	5.0%	7.5%	No	Yes	Yes	No, 180 day review period	Mains (includes cleaning & relining), valves, services, hydrants, meters, leak detection equipment, installation of production meters and pressure reducing valves	Yes
9.	California	4.0% Quarterly	7.0%	No	Yes	Yes	No	Capital projects approved by the California PUC and include wells, pumps, mains, hydrants, services, meters, tools & equipment	Yes
10.	New Hampshire	Company specific capital expenditures	7.5%	No	Yes	Yes	Yes	Mains (includes cleaning & relining), valves, services, hydrants, meters, installation of production meters and pressure reducing valves	Yes
11.	New Jersey	5.0%	5.0%	Yes	Yes	Yes, with initial filing	No, 60 day review by Board Staff and Division of Rate Counsel	Mains (includes cleaning & relining and costs of relocations due to street or highway construction), valves, services, hydrants,	Yes, General Rate Case required within 3 years of initial filing

Arizona Water Company
Docket No. W-01445A-11-0310
Summary of DSIC Programs in Other States

Line No.	State	Other
1.	Pennsylvania	Annual audit, true-up
2.	Illinois	
3.	Indiana	Annual true-up
4.	Delaware	Staff approval of projects up-front, annual true-up
5.	Ohio	
6.	Missouri	Annual true-up
7.	New York	Staff approval of projects up-front, annual true-up
8.	Connecticut	Staff approval of projects up-front, annual true-up
9.	California	
10.	New Hampshire	Staff approval of projects up-front, annual true-up
11.	New Jersey	Staff approval of projects up-front, annual true-up